DELTA ASSET MANAGEMENT

Second Quarter Letter 2019

PERSPECTIVE

At the half-way mark of 2019, the U.S. is marking 10 years of continuous economic growth. The current cycle of economic expansion is poised to become the longest ever recorded in this country's history based on statistics from the National Bureau of Economic Research. The longer the current expansion lasts, the more commentary swirls that it will end soon, followed by an inevitable and deep recession. Such pessimism is likely a residual memory from the severity of the 2008-2009 financial crisis. But while it is true the economy may be in the later phase of expansion, there are a number of structural advantages and recent reforms in the U.S. economy that may lessen the degree or length of a future downturn.

Evidence of comparative advantages in the U.S. economy relative to other economies can be found in the performance of the global stock markets. Since October 2007, the beginning of the financial crisis, international stock markets (excluding the U.S.) remain approximately 25% below their previous peaks. The U.S. S&P 500, however, has gained about 80% over the same time frame. This disconnect between the U.S. and the rest of the world goes against conventional wisdom, given that globalization and trade has generally linked and synchronized economies. The U.S. has enjoyed a robust stock market, low unemployment, and gross domestic product (GDP) growth that is the envy of the rest of the world.

Data from the National Bureau of Economic Research suggests that U.S. economic expansions are lasting longer, while economic contractions have become substantially shorter in duration.

Outside of the U.S., it's a different story. Since the beginning of the Great Recession, over 10 years ago, U.S. GDP has grown 34% in real terms versus -2% in the Eurozone, -15% in the UK and only 7% in Japan. In addition to the sovereign debt crisis and subsequent austerity measures, Europe's economy has been shackled by substantial amounts of regulation, restrictive labor laws and a macro central bank dictating a one-size-fits-all policy for 19 separate economies. Japan has been in a deflationary cycle for decades due to a declining population, a high-debt burden and a static corporate environment that avoids restructuring. Investment in the UK has been stifled by the uncertainty over Brexit and the prospect of a decidedly anti-growth / free enterprise alternative should the opposition party win the next election.

U.S. financial institutions are generally stronger and better regulated than their global peers. Following the Great Recession, U.S. regulators increased bank capital requirements and instituted a series of stress tests to force banks to reduce their leverage and in some cases limit or exit riskier businesses, such as proprietary trading. Across Europe, share prices of banks are valued at less than the book value of their equity, a sign that they have yet to resolve their problem loans. Chinese banks funded a huge increase in stimulus (on behalf of the

government) to ease the past crisis. The banks are now left with a massive increase in leverage and “zombie” loans – bad loans held by a practically insolvent bank – that are unlikely ever to be repaid.

The U.S. economy has long had relative comparative advantages in allowing and encouraging companies and financial firms to restructure, aided by fluid labor markets and a greater focus on maximizing shareholder investment. The U.S. also leads in research and development (R&D) spending, ranking No. 1 in absolute spending, representing over a quarter of global R&D investment. Recent reforms have lowered business taxes and substantially reduced regulations.

While many are anxious about the timing and depth of the next downturn, not all downturns are similar. The economy operates in cycles. For every expansion there is a corresponding contraction. Data from the National Bureau of Economic Research suggests that U.S. economic expansions are lasting longer, while economic contractions have become substantially shorter in duration. This variation may be partly attributable to the comparative advantages of the U.S. economy, which maintains its flexibility and entrepreneurial spirit.

The degree and timing of economic cycles are impossible to predict and thus basing buy and sell decisions on market timing is speculative at best. The key takeaway for an investor (as opposed to a speculator) during this extended expansion is to maintain a long-term focus and discipline, holding a quality portfolio through market cycles and viewing volatility opportunistically.

June 24, 2019

Company Comments

Comments follow regarding common stocks of interest to clients with stock portfolios managed by Delta Asset Management. This commentary is not a recommendation to purchase or sell but a summary of Delta’s review during the quarter.

The Walt Disney Company { DIS }

The Walt Disney Company is a global, diversified entertainment company with operations spanning theme parks, broadcast and cable television, movie production, consumer products and new online video streaming services. The company owns some of the world’s most valuable media brands, including ABC, Disney, ESPN, Lucasfilm (Star Wars), Marvel and Pixar. Disney’s broad media and entertainment breadth provides diversified distribution channels for the company’s creative content. Over the last several years, Disney has focused on three key strategic priorities: creating high-quality content for the entire family, making that content more engaging and accessible through the use of technology, and growing its brands and businesses in markets around the world. The management team, headed by Roger Iger, has proven very adept at creating value by generating multiple revenue and profit streams from its brands.

In March 2019, Disney acquired Twenty-First Century Fox (21CF) to further expand its global reach and broaden its content offerings to be incorporated into its film and TV production as well as its new streaming services. Disney also owns 70% of Hulu, a leading film and television direct-to-consumer streaming service, with a call option to buy the remaining Hulu interest from Comcast. In acquiring 21CF, the company will be acquiring a leading portfolio of film, pay TV and satellite assets spanning the globe reaching about 1.5 billion subscribers in approximately 50 local languages. Over the past five years, Disney and 21CF together have contributed about 35% film box-office market share.

Disney has focused on three key strategic priorities: creating high-quality content for the entire family, making that content more engaging and accessible through the use of technology, and growing its brands and businesses in markets around the world.

Disney's core strategy is to exploit characters and storylines by spinning them into multiple and enduring products. Disney showcases its unique brands through multiple platforms of the company, from films and TV shows to theme park rides to DVDs to toys and other consumer products. Disney estimates that it owns five of the top six character franchises based on merchandise and consumer sales. Disney is in the early stages of rolling out its valuable film and television content onto company-owned streaming services (Disney+, ESPN+ and Hulu) to compete with Netflix, among others. ESPN+ and Hulu alone already control a 20% market share in subscription services, and growth is expected to be rapid over the next five years as the company rolls out its highly anticipated Disney+ later in 2019.

Sports are Disney's major content edge. As consumer viewing options grow (internet and mobile media) and become more fragmented and viewing preferences change, "must see" live sports provide ESPN with an advantage over its traditional cable distributors and advertisers. ESPN profits from the highest affiliate fees per subscriber of any cable channel and generates revenue from advertisers interested in reaching adults ages 18 to 49, a key advertising demographic that watches more sports and less scripted television than other groups. These recurring, high margin cable affiliate fees provide profit stability in most economic backdrops.

Disney's theme parks and cruise lines contribute approximately 30% of operating income. In addition to the wholly-owned domestic parks, Disneyland and Disney World, the company has partial ownership and management contracts to operate several international parks in France, Hong Kong, Tokyo and now China. Disney has invested heavily the past few years adding new attractions, new resorts and new cruise ships as well as park expansions and upgrades. Disney theme parks are one-of-a-kind destinations that have competition, but nothing with the scale, magnitude, uniqueness or relevance for the entire family of the Disney experience.

Disney does face long-term challenges. The cost of sports programming rights continues to rise sharply, and ESPN pays handsomely to acquire major sports contracts. ESPN has been able to defray some of these costs by charging ever-increasing affiliate fees to cable operators. With such high fees, angst is growing among viewers, cable operators and program competitors. If ESPN cannot continue to pass along sports rights costs to cable operators, its profit margins will erode; however, profit erosion would be gradual due to ESPN's long-term contracts with both major sports leagues and cable operators. The high value of sports also has created additional competition for ESPN. All major broadcasters, such as FOX and NBC, and the major sports

leagues themselves have increased their investment in sports programming. More competition for viewers is likely to drive up the overall operating costs to broadcast sporting events over time.

Disney's proven ability to develop entertainment icons with increased consumer opportunities from merchandising royalties, positive cable pricing, theme park expansion and new film and TV online streaming services should allow the company to continue its good revenue growth with solid operating profit margins. Our valuation model suggests that the company's stock is priced to generate a long-term average annual rate of return of approximately 7%.

Microsoft Corp. { MSFT }

Microsoft is experiencing a renaissance under the leadership of Satya Nadella. He is the third CEO in the company's history. Since becoming CEO in February 2014, he has sought to change the company's culture and direction, orienting the company's products and services to a cloud computing centric world. Corporate America continues to transition to the cloud. A recent survey of more than 150 chief information officers revealed that only 23% of corporate technology workloads are currently on the cloud. This group predicts that the figure will rise to 52% by 2023.

Nadella's repositioning has borne good results. The company is now a clear No. 2 in cloud computing market share behind Amazon's web services (AWS). The gap is rapidly shrinking, as Microsoft's Azure cloud sales rose at a 76% clip in a recent quarter, compared with AWS' 46%.

In addition to leading the company to become a major player in the cloud, Nadella has brought some growth back to its legacy products. These products include Windows operating systems for personal computers, Office business solution applications, video games and its online search offering Bing. In addition, Microsoft designs and sells hardware, including the Xbox 360 entertainment and gaming console and assorted PC hardware products.

Microsoft's transformation to a cloud-based software company should allow it to lower its distribution costs and focus on its strengths, serving enterprise (business) customers.

Office, Microsoft's productivity software, has been reinvigorated by the launch of a cloud-based, subscription version known as Office 365. For legacy businesses such as Windows and Office, the company is moving from a transaction model to a subscription model, extending the lives of these businesses, expanding the market and setting the stage for a stronger recurring revenue structure. Updates and software fixes will be easier, and there will be a higher capture of revenue as leakage from piracy improves. Early in Nadella's tenure, Microsoft Office for iPad was launched as a signal that the company intended to serve its customers on any platform. He has overseen several critical product launches including Office 365, the Surface Pro 4 tablet and Windows 10. A key goal is to transform Windows into a ubiquitous cross-device operating system from a singular focus on

PCs. Nadella plans to direct investments to core productivity experiences and platform development for Office, Windows, and business systems, such as Azure and SQL Server.

Microsoft must continue to innovate even as it prolongs the life of its legacy products. Nearly a third of the company's workforce of 131,000 is dedicated to R&D. Last year the company added 500 capabilities to its cloud offering. The company spends 13% of revenue on R&D. Microsoft is acquisitive and does not shy away from making occasional large acquisitions. Its largest acquisition was acquiring LinkedIn for $26.2 billion. The company believes the professional social network can open new platforms for Dynamics (enterprise software for reporting and control) and Office.

In the past, several of Microsoft's investments (Bing, Nokia and Zune) have been outside of the company's core, and though we don't doubt the company's ability to invest its way to a viable business, the amount of capital committed in these efforts in the past made a compensatory return more challenging. Microsoft's transformation to a cloud-based software company should allow it to lower its distribution costs and focus on its strengths, serving enterprise (business) customers.

We anticipate that Microsoft will continue to develop and acquire a wide range of technologies and products, some of which will be outside of its core, and will experience relatively lower long-term returns on capital. Our valuation model indicates that at its present stock price, Microsoft offers a potential of an almost 6.5% annual rate of return.

Enbridge Inc. { ENB }

With the successful merger with Spectra Energy Corp in 2017, Canadian company Enbridge is now North America's largest energy infrastructure company with strategic pipelines transporting crude oil, natural gas and liquids. Enbridge's mainline system moves approximately 25% of North American crude oil. In gas transmission, the company reached peak deliveries on most of its systems and re-contracted more than 98% of the revenue that was up for renewal on its major pipes. Canada's oil sands supply is landlocked and separated from most of its refining markets by long distances and relies on pipelines for transport. Western Canada production is projected to exceed pipeline capacity in the near term, making the company's Mainline system and its access to various North American refining markets more valuable.

In addition to pipelines, the company operates a diverse energy portfolio as a distributor and operator of alternative energy. Enbridge owns and operates Canada's largest natural gas distribution company and provides distribution services in New Brunswick, Ontario, Quebec and New York State. Enbridge is also Canada's second largest wind and solar power generator. Beginning with its first investment in a wind farm in 2002, Enbridge committed $5.4 billion toward wind, solar, geothermal, power transmission and a host of other emerging technology projects. The segment accounts for a small but growing contribution to the company's consolidated earnings. The diversified generation portfolio largely focuses on wind (91% of current net generating capacity) but also encompasses other renewable sources.

Pipelines are characterized by relatively high barriers to entry due to high capital cost and significant regulatory oversight. Additional pipeline capacity is restrained by burdensome regulatory reviews, elusive right of way easements, lengthy development cycles and significant funding requirements. Regulatory approvals are granted typically only when an economic need for pipelines is demonstrated.

Generally, firms will not pursue expansion opportunities without securing contracted capacity. The company is insulated from direct commodity price exposure as approximately 95% of cash flow is underpinned by long-term, fee-based contracts. However, the cyclical supply and demand nature of commodities and related pricing can have an indirect impact on the business as shippers may continue to accelerate or delay certain projects.

Pipelines are characterized by relatively high barriers to entry due to high capital costs and significant regulatory oversight.

In February 2017, Enbridge completed its merger with Spectra Energy. The transaction was valued at $37 (Canadian) billion dollars. The merger made Enbridge the largest North American energy infrastructure company. The Spectra acquisition included a high-quality backlog of pipeline and midstream projects that support the company's guidance for approximately 10% dividend growth through 2020.

The firm's challenges include garnering multiple jurisdictional approvals for one its major capital investments: the Line Three Replacement project. After a 43-month regulatory review, the Minnesota Public Utilities Commission granted its approval. The state of Minnesota has now provided a timeline to finalize its remaining permits before the end of 2019. The project is expected to be in-service in the second half of 2020.

Regulated assets are subject to economic regulation risk by which regulators and other government entities may change or reject proposed or existing projects, including permits and regulatory approvals for new projects. Enbridge's long-term thesis hinges on the ability to secure additional growth projects that drive earnings and dividend growth.

With Enbridge positioned to benefit from growing oil sands supply with its Mainline system and regional pipelines, we believe the company is set to generate significant free cash flow, allowing the company to grow its dividends and fund crude pipeline expansions. Based on these assumptions, our valuation model indicates a long-term average annual return of 12.5%.

3M Company { MMM }

3M is a diversified global technology innovator and marketer of a wide variety of products. With more than 80,000 employees, 3M produces over 55,000 products, including abrasives, adhesives, laminates, fire protection products, dental products, electronic materials and healthcare products. Roughly 90% of its revenues are consumable products creating recurring revenue streams. 3M's unusual breadth shields it against overreliance on any one market. The company's products are available for purchase in more than 200 countries.

The company is well positioned to benefit from several themes, including efficiency in healthcare, water and air quality, aging populations, industrialization in emerging markets, alternative energy and infrastructure upgrades. 3M has consistently reported best-in-class operating margins over the past 20 years. The company's premium margin is largely attributable to its scale, vertically integrated operations, lean manufacturing processes and differentiated brands.

In 2018, over 60% of sales were international. The company has a global manufacturing base with 40% of its plants outside of North America. Sales in developing countries have grown at a 10% compound rate over the past decade. Emerging market exposure is now 35% of sales, up from 21% in 2003. Localized production, sales and distribution have enabled the company to earn higher margins in emerging markets than in domestic markets. In addition to leading innovations, growth will continue to be driven by emerging market expansion.

3M's culture of innovation has carved a moat around its businesses. Strengthening its innovative roots, the company is increasing R&D as a percent of sales to 6% by 2020 versus the median 3% for many industrial companies. The investment in R&D has paid off. In recent years, 3M launched over 1,300 new products and won 3,000 patents. The company positions its R&D and capital expenditure spending with a long-term focus. Over time, 3M has been able to develop not only improvements in products currently being sold but also create entirely new product areas. The company's vertical integration amplifies its R&D spend. Although 3M sells thousands of products to wide-ranging end markets, the firm cites only a few dozen technology pillars that support its vast array of offerings creating significant economies of scale. We expect this practice to continue, with the effect of protecting profit margins through higher priced new product introductions.

3M's premium margin is largely attributable to its scale, vertically integrated operations, lean manufacturing processes and differentiated brands.

The company does face challenges. Though 3M has adequate long-term growth prospects and good market positions in most end markets, it is tied to cyclical industries in all its business lines. Revenue and profitability will weaken during a recessionary period. Management's business transformation plans – including the process of standardizing global business practices with an integrated IT system and supply chains – can be cumbersome and complicated with the potential for cost over-runs. Further, the company's chemical manufacturing processes have led to environmental lawsuits and may continue to do so with unknown liabilities. Historically, the settlements have been modest.

With strong consumer and industrial brands, a track record of innovation and low-cost manufacturing, 3M has competitive advantages over smaller industry players. Given these advantages and our assumptions of low-single digit revenue growth and 23% operating margins, we believe that 3M's present stock price offers the potential for an average annual long-term rate of return over 9%.

S&P Global

S&P Global Inc. { SPGI }

S&P Global is a leader in credit ratings, benchmarks and analytics that provides essential information and data content to the global capital, commercial and commodity markets. Its brands include Capital IQ, Dow Jones Indices, Platts, S&P Indices and Standard & Poor's. These businesses have a large global footprint, good market penetration, are highly scalable, require little capital investment and generate high profit margins and strong free cash flow.

S&P has completed a multiyear restructuring and is now focused on its faster-growing financial businesses, including the lucrative and not very competitive business of rating bonds. The centerpiece of this plan was the sale of its publishing businesses and divestiture of smaller, non-core businesses. The company has also made important acquisitions, such as data and analytics provider SNL Financial to complement existing data offerings and expand its geographic reach. The business transformation project has created a company with a higher revenue growth and operating margin profile.

S&P Ratings, which makes up 50% of total company profitability, is one of the three dominant firms that rate securities and assess credit risk (the other two are Fitch and Moody's). The three firms issue more than 95% of global bond ratings, a total virtually unchanged from the pre-2008 period. Barriers to entry, such as market acceptance and reputation, scale, global distribution, network effects and complex regulations, are high. Credit ratings are used by investors, issuers, investment banks and governments. Credit ratings provide the marketplace with a benchmark to help gauge borrowers' credit worthiness. Most issued bonds have at least one rating from a respected Credit Rating Agency (CRA) for the issuance to be successful. S&P Ratings and other credit rating firms benefit from a unique market structure that favors an oligopoly. Customers want two or three ratings so as to minimize the time management must spend with analysts, to diversify their risk that one analyst gets it wrong and to lower their financing costs.

S&P's businesses have a large global footprint, good market penetration, are highly scalable, require little capital investment and generate high profit margins and strong free cash flow.

Though CRAs have won most criticisms and lawsuits resulting from missteps made during the credit crisis, the risk remains. The Dodd-Frank law includes a provision that makes it somewhat easier to sue CRAs for securities fraud. The global regulatory framework has become more difficult with greater scrutiny and oversight. Although we anticipate a limit to margin growth due to additional regulations and constraints, we believe the major CRAs, such as S&P, have the global presence, resources and reputation to promote market efficiency and to remain highly profitable.

Separate from S&P Ratings, the company's S&P Indices and S&P Market Intelligence segments are large and highly profitable global businesses with good growth prospects. S&P's indices provide investors with well-known market benchmarks, including the Dow Jones Industrial Average and S&P 500. The S&P 500 is the world's most followed stock market index with almost $10 trillion in benchmarked assets. Growing investor demand for index-based passive

investments has boosted the share of exchange traded funds (ETFs) and index mutual funds, increasing the fees paid to S&P Indices for the use of its benchmarks.

S&P Market Intelligence, which includes Capital IQ, is a leading global provider of financial research, data and analytical tools for asset managers, investment banks, brokers and analysts. The global capital and commodity markets have become more integrated, driving increased demand for data and analytics. Market Intelligence continues to gain market share as it acquires, develops and integrates additional mission critical data and analytics content.

Though S&P Global's businesses are cyclical, we believe its strong position in each of its businesses that provide critical information to capital, commercial and commodity markets have created a good long-term growth and margin profile. We assume mid-single-digit revenue growth with operating margins averaging more than 40% over the long-term. Based on these assumptions, our valuation model indicates almost 7% annualized long-term rate of return given the current stock price.

General Mills, Inc. { GIS }

General Mills is a leading consumer foods company with a large stable of branded products, including breakfast cereal, refrigerated dough, baking mixes, snack foods, ice cream and yogurt. The company's portfolio of leading brands includes Betty Crocker, Blue Buffalo, Cheerios, Fiber One, Haagen-Dazs, Nature Valley, Pillsbury, Progresso and Yoplait.

In April 2018, the company meaningfully reshaped its product portfolio by acquiring Blue Buffalo, a high-growth, natural pet food manufacturer and distributor that generated $1.3 billion of sales in 2018.

The company's competitive strength is derived from its market-leading brands, economies of scale and expansive distribution network. General Mills controls the No. 1 or No. 2 market share position in almost every product category in which it competes (30% share U.S. ready-to-eat cereal, 70% refrigerated baked good, 40% grain snacks). The company has developed its leading market share positions by continuously investing to improve established brands and creating new products. The management team, led by CEO Jeff Harmening, is very adept at growing new products and building brand equity through heavy consumer-focused marketing strategies.

General Mills generates approximately 71% of its revenue and profits in the mature U.S. market. Though growth should be moderate, the company's focus on product innovation and brand support through heavy advertising should continue to protect its market share position. The company's leading product offerings likely will benefit from consumer trends, such as snacking, increased meals at home and a growing health and wellness focus. In addition, the company is expanding internationally in both developed regions, such as Europe, and faster-growing markets, including China and Latin America. General Mills has good revenue and earnings growth potential in these regions as the company further develops its distribution network and expands its product offerings.

General Mills has a culture of operating efficiency. The company takes a holistic, company-wide approach to improving productivity and reducing costs throughout its entire supply chain. These continuous cost savings measures allow the company to invest in its brands for future growth and maintain industry leading profitability and free cash flow.

In April 2018, the company meaningfully reshaped its product portfolio by acquiring Blue Buffalo, a high-growth, natural pet food manufacturer and distributor that generated $1.3 billion of sales in 2018. Blue Buffalo is one of the strongest and most recognizable pet food brands in the U.S. and is a leader in the natural pet food business, one of the fastest growing segments. Recently, the company announced that Blue Buffalo will be available in Walmart, a move that could substantially increase the brand's distribution.

The company faces its share of challenges, including retail customer consolidation and strong competition in the packaged foods industry. Retail consolidation has given General Mills' customers greater control over product pricing and store shelf space. In addition to branded competitors, the company faces increased competition from private label products and natural, organic products. General Mills' sizable international expansion plans, including infrastructure build-outs, new product introductions and acquisitions, must be executed effectively to generate adequate returns on invested capital.

Given General Mills' concentration in mature markets, combined with increasing exposure to faster-growing international markets, we have assumed the company can grow revenue in the low-single digits annually over the next decade. At this pace of growth and given the company's intense focus on reducing costs, we believe cash flow margins can average 19% over this period. Based on these assumptions, our stock valuation model indicates General Mills' current stock price offers a long-term average annual rate of return of approximately 7.5%.

Dated: June 24, 2019

Specific securities were included for illustrative purposes based upon a summary of our review during the most recent quarter. Individual portfolios will vary in their holdings over time in relation to others. Information on other individual holdings is available upon request. The information contained herein has been obtained from sources believed to be reliable but cannot be guaranteed for accuracy. The opinions expressed are subject to change from time to time and do not constitute a recommendation to purchase or sell any security nor to engage in any particular investment strategy. Any projections are hypothetical in nature, do not reflect actual investment results and are not a guarantee of future results and are based upon certain assumptions subject to change as well as market conditions. Actual results may also vary to a material degree due to external factors beyond the scope and control of the projections and assumptions.